



# Uniform Law Commission

NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

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April 24, 2012

Rep. John Walsh  
Michigan House of Representatives  
Anderson House Office Bldg.  
124 N. Capitol  
N-698 House Office Building  
Lansing, MI 48933

**RE: HB 5154 - Uniform Principal and Income Act Amendments**

Dear Rep. Walsh,

I write in support of HB5154, which would enact amendments to the Uniform Principal and Income Act, and urge its passage.

Trusts are often separated into income, which is distributed to current beneficiaries, and principal, which will eventually be distributed to remainder beneficiaries. The Uniform Principal and Income Act (UPIA) provides procedures for trustees administering an estate to separate trust assets into principal and income based on the intentions of the trust creator.

Michigan adopted the UPIA in 2004, joining 45 other jurisdictions that have enacted the UPIA.

In 2008, the Uniform Law Commission (ULC) issued three UPIA amendments, and recommended their adoption by all states that previously adopted UPIA. These amendments were necessary for two reasons. First, the IRS issued a revenue ruling in 2006 that found that existing UPIA Section 409, which deals with the rules that apply to IRA and qualified plan payments to a marital trust, could be ineffective, and would result in the loss of an estate and gift tax marital reduction for the trust. Second, practitioners urged amendment to Section 505, which deals with the treatment of income tax payments that are owed and made on income earned on so-called pass-through entities, such as partnerships, LLC's and Sub S corporations that are owned by a trust.

HB5154 corrects these problems and addresses the tax consequences of certain actions by a trustee. There are three specific changes to the existing UPIA that will be effectuated by this legislation.

HB5154:

1. Amends Section 409, bringing the UPIA into compliance with IRS Revenue Ruling 2006-26, concerning trusts that qualify for the estate tax marital deduction.

2. Amends Section 505, allowing a mandatory income trust that owns a business entity to meet its income tax obligations with no out-of-pocket contribution from a trust beneficiary.
3. Amends Section 606, clarifying an administrative provision concerning the effective date of the amendment to Section 409.

#### **Amendment to UPIA Section 409**

Section 409 applies to marital trusts designated as the beneficiary of an IRA or other qualified retirement plan. As part of an estate plan, a married retirement plan participant may elect to designate a marital trust as the plan beneficiary, rather than a spouse. If the trust qualifies for the federal estate tax marital deduction, the spouse can receive income from the trust, but the estate tax is not incurred until the spouse dies.

In its 2006 Revenue Ruling, the IRS criticized the original UPIA formula for allocating retirement plan distributions between principal and income. The amendment revises the UPIA formula to bring it in line with IRS safe-harbor regulations and ensure that the estate receives the intended tax benefit.

#### **Amendment to UPIA Section 505**

Section 505 concerns trusts that own a business interest in a company organized as an LLC, partnership, or other pass-through entity. Owners of such a business must report their share of business revenue as taxable income, whether the owner actually receives the income or the income is reinvested in the business. To relieve the owners of an unfunded tax burden, a business will often distribute only enough revenue to pay the tax due. This strategy works well when the owners are individuals, but can be problematic when a trust is the owner. If the terms of the trust require all income to be distributed to trust beneficiaries, the beneficiary, as opposed to the trust, may become liable for income tax on the amount distributed.

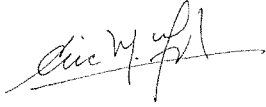
In its current form, Section 505 is ambiguous and it fails to clearly tell a trustee how to deal with that income when the trustee does not have sufficient cash to make an income tax payment. With the passage of this bill, the amended Section 505 provides a new formula for calculating the amount of income that must be distributed to beneficiaries. The proposed change clarifies that the trust will keep the funds necessary to pay its taxes, and distribute the balance of the income to any mandatory income beneficiary.

#### **Amendment to UPIA Section 606**

Section 606 is simply an administrative provision that describes the applicability of revised Section 409 based on the funding status of the trust, and facilitates the technical implementation of the amended language. The ULC provided two alternative versions of Section 606: Alternative A is for states like Michigan that have previously adopted the UPIA. Alternative B is for states that are enacting the UPIA for the first time. House Bill 5154 uses Alternative B, and should be amended to use Alternative A, which adds the words “as amended by this [amendment]”.

In summary, enacting the UPIA amendments contained in House Bill 5154 will ensure that Michigan law complies with current IRS regulations, and that Michigan residents will receive the full tax benefits to which they are entitled. There is no fiscal impact to the state. 30 other jurisdictions have enacted these changes, which are widely supported by practitioners of trust and estate law. The ULC urges the committee to recommend adoption of House Bill 5154, with the minor change to Amendment 3 referenced above.

Sincerely,

A handwritten signature in black ink, appearing to read "Eric M. Fish", with a long horizontal flourish extending to the right.

Eric M. Fish  
Legislative Counsel